

**Statement of**

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**Before the**

**Subcommittee on Commercial and Administrative Law  
House Committee on the Judiciary  
U.S. House of Representatives**

**On**

**H.R. 1369  
Relating to State and Local Taxation of Interstate Natural Gas Pipelines**

**October 6, 2005**

Chairman Cannon, Congressman Watt and Members of the Subcommittee:

Thank you for the opportunity to appear before the Subcommittee on H.R. 1369, a measure that would impose certain restrictions on state and local taxation of interstate natural gas pipelines. My name is Harley Duncan, and I am the Executive Director of the Federation of Tax Administrators. The Federation is an association of the principal tax administration agencies in the 50 states, the District of Columbia and New York City. I appear in opposition to H.R. 1369.

H.R. 1369 imposes several limitations on state and local taxation of natural gas pipelines. To a considerable extent, the limitations are fashioned along the lines of those contained in the Railroad Revitalization and Regulatory Reform Act (4-R Act) of 1976. The bill would prohibit states from assessing pipeline property at a higher ratio to true

market value than is the case for other commercial and industrial property in the same assessment jurisdiction or from imposing an ad valorem property tax on natural gas pipeline property at a higher tax rate than is applied to other commercial and industrial property in the jurisdiction. It would also prohibit states and localities from imposing “any other tax that discriminates” against a natural gas pipeline. Finally, the bill would grant the federal district courts jurisdiction over actions arising under the bill. It would provide that relief is to be granted if the assessment ratio of pipeline property exceeds that of other commercial and industrial property by more than 5 percent. It further provides that if the assessment ratio of commercial and industrial property cannot be ascertained through a valid sales-assessment ratio study, relief is to be granted if pipeline property is assessed or taxed at a rate greater than “all other property (excluding public utility property) subject to a property tax levy”.

H.R. 1369 should be opposed for several reasons:

It will disrupt the property tax systems in a number of states where the voters have chosen to adopt a classified property tax system that taxes certain types of property differently from others. These classified systems have been approved by the voters in these states and have been found constitutionally valid where challenged. H.R. 1369 will also be used to challenge the property tax systems in states without such a classification system.

The “any other tax” provision of the bill is an insidious measure that is likely to be used (if experience is any guide) to challenge a number of features of the tax and regulatory systems involving natural gas pipelines.

The provision authorizing access to the federal court system to bring actions under the bill is unnecessary and will be disruptive to the tax administration system in many states.

The bill will (once again, if experience is any guide) spawn a tremendous amount of litigation and consume immeasurable resources to determine its ultimate meaning and impact.

The bill is in many ways a solution in search of a problem. A rather exhaustive review of literature in the tax and public policy field failed to identify a single treatise on the property tax issues facing the interstate gas pipeline industry. The information that is available suggests that the primary “justification” for the bill is that Congress enacted similar legislation affecting the property taxation of railroads about 30 years ago when most U.S. railroads were in serious financial difficulty. On the basis that one group has it, the pipeline industry is now coming forward seeking similar treatment.

### **Classified Property Tax Systems**

State property tax systems can be divided into two types: classified systems in which certain types of property (identified in either the state constitution or state law) are taxed differently (either assessed at a different proportion of fair market value or taxed at a different rate) from other types of property and non-classified systems in which all property is valued at the same ratio to fair market value and is taxed at the same rate (usually called a “uniform and equal” state.)<sup>1</sup> In each state with a classified property tax system, the system has been authorized by the state constitution by whatever procedure is specified for adopting constitutional provisions in that state, but usually involving approval by the voters in that state. The actual classifications and tax rates are contained in the Constitution or adopted in law through the normal legislative process. The ability to use a classified property tax system, at least as they have been implemented to date, has been upheld.

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<sup>1</sup> At least 18 states use a classified property tax system. It appears that in 9 of these states natural gas pipelines are in a class that is taxed at a higher rate than some other commercial and industrial property while in 9 others all commercial and industrial property is taxed in the same manner. Source: Survey of Railroad and Utility Taxation among the States: 2005 Update, New York State Office of Real Property Services. Available at <http://www.orps.state.ny.us/ref/pubs/railroadutility/index.htm> as of October 3, 2005.

Some states use a classified property tax system as a tool for calibrating the distribution of the property tax burden across income groups and the incidence of the state and local tax systems as a whole. In others, a classification system has been used to keep the relative shares of the property tax burden constant across property types as the state transitioned to an updated property tax system. Enactment of H.R. 1369 would disrupt these classification systems that have been adopted through the duly authorized procedures required in each state. It would, in effect, insert the will of Congress and overturn decisions made by voters and elected officials in the affected states. The end result will be a shift of some portion of the property tax burden to other property owners.

Undoubtedly, a considerable portion of the concern expressed by the pipeline industry is attributable to the fact that states have often had to exclude railroad property from the class into which other centrally assessed property (generally including pipelines) would be included because of the requirements of the 4-R Act. The result is to reduce property taxes on railroads relative to natural gas pipelines.

While one of the principles of tax policy is that taxes should be neutral across similar activities and should not distort economic decisions, differential taxation resulting here should not be laid exclusively at the feet of states and local governments. It is axiomatic that if Congress intervenes in state and local taxation in a manner that establishes a favored group of taxpayers, then other taxpayers that feel they are in the same position will come forward seeking the same favored treatment. Complaints about the differential impact of state classification systems on natural gas pipelines vis-à-vis railroads must be considered to be largely the result of previous Congressional intervention. Passage of H.R. 1369 to address the concerns of the pipeline industry will undoubtedly add to the list of those petitioning Congress for redress of perceived grievances and compound the problem created by the 4-R Act. It will also disrupt approved classification systems and shift the property tax burden among various property classes.<sup>2</sup>

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<sup>2</sup> Note that the issue of whether natural gas pipelines are entitled to the same treatment as railroads under the state constitution and the U.S. Constitution has been litigated and decided against the pipelines in one

Concerns about assessment rates will not be confined only to the states with classified property tax systems. Pipelines should be expected to generate actions challenging the actual assessment ratio for pipelines compared to other property in “uniform and equal” states as well. To the degree that they can achieve relief, it will shift the burden to other taxpayers.

### **“Any Other Tax” Provision**

At first blush, the “any other tax” provision (Section 1(b)(4) of the bill) seems innocuous and straightforward. In the 4-R Act context, the counterpart provision was described as a backstop designed to prevent states from enacting new taxes to replace property tax practices that would be replaced. In reality, however, the provision was used to attack a number of state and local tax and fee arrangements that were pre-existing and would not be considered improper discrimination.

Among the challenges brought under the “any other tax” provision of the 4-R Act were:<sup>3</sup>

The imposition of a personal property tax on a railroad company’s rolling stock. *Burlington Northern and Santa Fe Railway Co. v. Missouri State Tax Commission*, No. 98-3544 (8th Cir. 1999).

Ohio’s excise tax imposed on the rolling stock of railroads levied in lieu of personal property (rolling stock and other personal property). *General American Transportation Corp. v. Limbach*, Civ. No. C2-285-1603 (S.D. Ohio, 1987).

Louisiana’s gross receipts license tax on railroads was struck down despite the fact that it applied to all utility industries and had been in existence since 1935. *Kansas City Southern Railway Co. v. McNamara*, No. 817 F.2d 368 (5<sup>th</sup> Cir. 1987).

Imposition of an Iowa excise tax on intrastate consumption of fuel by railroads with funds earmarked for a special fund that was used to rehabilitate abandoned

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state. *Colorado Interstate Gas Co. and ANR Pipeline Co. V. Beshears*, No. 85,052, Kansas Supreme Court, June 1, 2001.

<sup>3</sup> This is not to suggest that all these challenges were successful. It does, however, demonstrate the breadth of measures that were attacked under the “any other tax” provision, and the types of litigation that should be expected if H.R. 1369 is approved.

rail lines for ultimate sale or lease back to the railroads. *Atchison, Topeka & Santa Fe Railway v. Bair*, 338 N.W.2d 338, cert. denied, 465 U.S. 1071 (1984).

Imposition of sales and use tax on purchases of fuel by railroads was challenged under section 306(1)(d) of the 4-R Act. *Burlington Northern R. Co. v. Commissioner of Revenue*, Nos. 6911, 6865 (Minn.Tax, 1999), reversed by: *Burlington Northern R. Co. v. Commissioner of Revenue*, 606 N.W.2d 54 (Minn. 2000).

Manner of applying the Virginia corporate net income tax to railroads. *Richmond, Fredericksburg & Potomac R. Co. v. Department of Taxation, Com. of Va.*, 762 F.2d 375 (4<sup>th</sup> Cir. 1985).

Alabama franchise tax on railroads measured by gross receipts from their Alabama intrastate business. *Alabama Great Southern R. Co. v. Eagerton*, 663 F.2d 1036 (11<sup>th</sup> Cir. 1981).

New Jersey railroad franchise tax in lieu of general corporate business tax challenged under 4-R Act. *CSX Transportation v. Director, Division of Taxation*, No. 004036-00 (N.J. T.C. 2005).

Collection of tax by state rather than local governments and possibility of a more accurate method of estimating tax base challenged under Section 301(6)(d) of 4-R Act. *Union Carbide Corp. v. Board of Tax Commissioners of the State of Indiana*, 69 F.3d 1356 (7<sup>th</sup> Cir. 1995).

Wyoming coal transportation tax. *Burlington Northern and Santa Fe R. Co. v. Atwood*, 271 F.Supp.2d 1359 (D. Wyo. 2003).

California assessment of its use tax on passenger rail cars purchased tax-free outside the state, and first used in California. *National Railroad Passenger Corp. v. California Board of Equalization*, 652 F.Supp. 923 (N.D. Cal. 1986).

Private car tax imposed by the state of Missouri on rentals derived from the leasing of railroad cars. *Trailer Train Co. v. State Tax Com'n*, 929 F.2d 1300, 1301 (8<sup>th</sup> Cir. 1991).

Imposition of a levy to recoup the costs of regulating railroad operations within the state. *Union Pacific R. Co. v. Public Utility Com'n of State of Or.*, 899 F.2d 854 (9<sup>th</sup> Cir. 1990).

Bridge construction and maintenance costs assessed against railroads. *Wheeling & Lake Erie Railway Co. v. Public Utility Commission of Pennsylvania*, 141 F.3d 88 (3<sup>rd</sup> Cir. 1998).

Costs of building culverts under railroad tracks assessed against railroads. *Chicago and Northwestern Transportation Co. v. Webster County Board of Supervisors*, 71 F.3d 265 (8<sup>th</sup> Cir. 1995).

Fee used to cover the costs of constructing and improving railroad grade crossings. *Burlington Northern and Santa Fe Railway Co. and Union Pacific Railroad Co. v. Atwood*, No. 00-CV-109-J (D. Wyo. 2003).

Imposing costs of drainage ditch on railroad. *Chicago and North Western Transportation Co. v. Webster County Board of Supervisors*, 71 F.3d 265 (8<sup>th</sup> Cir. 1995).

It is evident that in the 4-R Act context, the “any other tax” provision has been far more than a backstop to prevent states from offsetting changes in the property taxation of railroads by other means. It was used as a tool to try to reduce the costs imposed on the railroad industry by government, many of which were used to benefit the railroads directly through the maintenance of rights of way, crossings and the like.

It is important to note that challenges under the “any other tax” provision did not need to allege that the challenged taxes “discriminate” against railroads in a way that violated constitutional principles. Neither was it necessary to show that the impact of the state and local system as a whole was discriminatory against railroads or that it imposed a greater burden on railroads than it imposed on other industries or that the burden was out of proportion to the services provided by states and localities to the railroads. Instead, the judicial interpretation of the statutory language was based primarily on the fact that the imposition on railroads was different from that imposed on other businesses. In many cases, the levies were unique to railroads because they were used for purposes affecting only railroads. In short, the “any other tax” provision will, if history is a guide, be used to challenge a wide range of taxes and fees that may differ from the treatment accorded other taxpayers, but that would not be found to improperly discriminate under traditional constitutional principles.

So that you may be fully aware of the implications of Section 1(b)(4), proponents of H.R. 1369 should identify the particular tax arrangements that exist today that they believe would be subject to challenge under the “any other tax” provision. This seems

particularly important given that some states have deregulated portions of their energy industries and have altered their tax structures as a result. The result has been the adoption of certain excises on various segments of the industry to replace levies that became obsolete with the deregulation. With such a disclosure, the Subcommittee could evaluate the full impact of the “any other tax” provision as it moves forward.

### **Federal Court Jurisdiction**

The grant of authority to the federal court system to hear cases arising under H.R. 1369 is an unnecessary and disruptive provision. The federal Tax Injunction Act (28 U.S.C. §1341) provides that the federal courts are to demur from hearing state tax cases where there is a “plain, speedy and efficient” remedy available at the state level. Each state does, in fact, provide avenues to challenge various aspects of the property tax administration system with which the pipelines are concerned through both administrative review bodies and the state judicial system. These venues can be used to challenge the appraised value, equalization with other properties, and whether the state is meeting all the requirements of its property tax law as well as bring constitutional claims regarding discriminatory treatment. Beyond this, the pipeline industry can, of course, and does avail itself of the state legislative process for resolution of its issues. In that setting, elected officials at the state level, viewing the issue in the context of the state’s tax system overall can make a judgment regarding the merits of the pipelines’ case. In short, there is no need for federal court jurisdiction in this area. The existing avenues of appeal are plenty.

Moreover, by affording direct access to federal courts in challenging state and local property tax assessments, Section 2(a) promotes discrimination by creating a privileged class of taxpayers that may avoid the traditional state or local judicial and administrative review process. Experience with similar legislation has shown that federal courts do not consider 4-R Act challenges to state taxation in the same context as state courts, which must weigh tax cases in the context of state constitutions, state laws and the state tax system as a whole. Further, federal courts have used a separate line of precedent and reasoning that results in special treatment for such property tax payers, which

inevitably leads to unfair results for those property tax payers without access to federal courts. In short, separate justice is not equal justice.

Finally, providing access to the federal court system will disrupt the financial condition and potentially threaten the financial integrity of affected local governments. Granting direct access to federal courts over a disputed assessment would allow taxpayers to withhold disputed taxes while the case moves forward, thereby making it difficult for local governments and school districts to determine their tax base or to receive even preliminary payment of taxes until years after the taxes are due. The normal procedure at the state level is that the taxes must be paid and the claim brought as a claim for a refund.

### **Spawning Litigation**

If H.R. 1369 is passed, one thing is certain. It is likely to create a veritable tidal wave of litigation to ascertain the meaning of the Act and the manner in which it should be applied in individual states. As noted above, just the “any other tax” provision of the 4-R Act generated a number of challenges to state and local tax practices. In addition, there were a wide range of other cases brought to determine more fundamental matters about the Act. As outlined in the attached article by from the March 1991 Multistate Tax Commission Review (Attachment I), this litigation includes such matters as whether the 4-R Act was constitutional, whether it constituted an abrogation of the sovereign immunity of the states, the appropriate contours of the classes of property to which railroads should be compared, the techniques to determine the assessment ratio of various types of property, the proper treatment of various classes of exempt property and the like.

While the language of H.R. 1369 has been informed to a degree by the 4-R Act litigation, one should not assume that its meaning and application is intuitively obvious. In addition, there are likely to be actions in a number of states challenging the assessment ratio of commercial and industrial property even in states without a classification system.

These actions will consume large amounts of resources to gather the required information and defend.

## **Conclusion**

H.R. 1369 represents an attempt by the interstate natural gas pipeline industry to use the power of Congress to carve out for it a special position in the state and local property tax system. H.R. 1369 would overturn the decisions of voters and state and local elected officials about the appropriate tax policy for the citizens in the state and the businesses operating in that state. In so doing, it would shift some portion of the property tax burden in affected states and localities to taxpayers that do not receive the preferential treatment. In addition, H.R. 1369 would allow the pipeline industry to pursue redress of their grievances in federal courts when there are avenues at the state and local level that are available to them to pursue their concerns. In fact, they have used those avenues, and do not like the answers they have received. It is for that reason that they turn to the Congress with their concerns.

Finally, H.R. 1369 is simply a case of “me too-ism.” Congress at a different time and in different circumstances accorded similar relief to the railroad industry. Now the pipeline industry seeks the same treatment without a showing as to need or impact. Of one thing we can be sure, if H.R. 1369 is approved, they will not be the last industry coming before this body seeking special status.